BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
ALLEN C. AND MILDRED ANDERSON)

Appearances

For Appellants: James Vizzard, Attorney at Law

For Respondent: F. Edward Caine, Senior Counsel

O P I N I O N

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Allen C. and Mildred Anderson to proposed assessments of additional personal income tax in the amounts of $2,273.85, $2,333.46, $2,883.02, $2,962.12, $2,911.06 and $2,659.93 for the years 1952, 1953, 1954, 1955, 1956 and 1957, respectively,

Appellant Allen C. Anderson (hereinafter referred to as appellant) owned and operated a coin machine business in the Shafter and Wasco area of Kern County under the name of Anderson Amusement, He owned music machines, flipper pinball machines, multiple-odd bingo pinball machines, cigarette vending machines and miscellaneous amusement machines,, The equipment was placed in some 25 locations such as bars and restaurants, The proceeds from each machine except cigarette machines, after exclusion of expenses claimed by the location owner in connection with the operation 0f the machine, were divided equally between appellant and the location owner. With respect to cigarette machines, appellant paid the location owners amounts varying from a cent and a half per package sold to as high as 10 percent of the gross.

The gross income reported in appellant's tax returns was, except as to cigarette vending machines, the total of amounts retained by appellant from locations. The gross income reported by appellant as to cigarette vending machines was the total of the coins deposited in the machines. Deductions were taken for depreciation, cost of phonograph records, salaries and other business expenses.

Respondent determined that appellant was renting space in the locations where his machines were placed and that all the coins deposited in the machines constituted gross income to him. Respondent also disallowed all expenses pursuant to section 1729'7 (1'7359 prior to June 6, 1955) of the Revenue and Taxation Code which reads:

> In computing taxable income, no deductions shall be allowed to any taxpayer on any of his gross income derived from illegal activities as defined in Chapters 9, 10, or 10.5 of Title 9 of Part 1 of the Penal Code of California; nor shall any deductions be allowed to any taxpayer on any of his gross income derived from any other activities which tend to promote or to further, or are connected or associated with, such illegal activities,

The evidence indicates that the operating arrangements between appellant and each location owner were, except as to cigarette vending machines, the same as those considered by us in Appeal of Hall, Cal, St. Ed. of Equal,, Dec. 29, 1958, 2 CCH Cal, Tax Cas. Par. 201-197, 3 P-H State & Local Tax Serv. Cal. Par, 58145, Cur conclusion in Hall that the machine owner and each location owner were engaged in a joint venture in the operation of the machines is, accordingly, applicable here.

The evidence indicates that the operating arrangements between appellant and each location owner as to cigarette vending machines were the same as those considered by us in Appeal of Reinert, Cal, St, Bd. of Equal., March 22, 1962, 3 CCH Cal. Tax Cas. Par. 201-913, 3 P-H State & Local Tax Serv. Cal, Par, 58232, Our conclusion in Reinert that the machine owner rented space in the locations for his cigarette vending machines and that the machine owner's gross income from such machines was the entire amount of coins deposited therein is, accordingly, applicable here,

In Appeal of Advance Automatic Sales Co., Cal, St. Bd. of Equal,, Oct. 9, 1962, 3 CCH Cal. Tax Cas. Par, _____, 2 P-H State & Local Tax Serv. Cal. Par, 13288, we held the ownership or possession of a pinball machine to be illegal under Penal Code sections 330b, 330.1 and 330.5 if the machine was predominantly a game of chance or if cash was paid to players for unplayed free games, and we also held bingo pinball machines to be predominantly games of chance,

The evidence as to cash payouts is not without conflict but three locations owners testified that cash payouts were made in redemption of free games won on multiple-odd pinball machines,, One location owner testified that he never made such payments but he had stated the contrary to respondent's agents in 1958 and again a few days prior to the hearing in this appeal, Appelant also testified that machines had been drilled. This permits the wrongful manipulation of the mechanism by the insertion of a wire or other object, a form of cheating which would be unlikely in the absence of such payouts, From the evidence before us we conclude that it was the general practice to make cash payouts to players of these machines for free games not played off, Accordingly, this phase of appellant's business was illegal, both on the ground of ownership and possession of

bingo pinball machines which were predominantly games of chance and on the ground that cash was paid to winning players, Respondent was therefore correct in applying section 17297.

Appellant had two employees, a collector and a mechanic. The collector collected from all types of machines owned by appellant, The mechanic repaired all types of machines owned by appellant. There was a repair shop where the more difficult repair work was done. Appellant solicited new locations and in doing so tried to place as much of his equipment as possible, Appellant had music machines in virtually all of his locations, cigarette machines in about 90 percent of his locations and pinball machines in from 50 percent to 75 percent of his locations,

We find that there was a substantial connection between the illegal activity of operating multiple-odd bingo pinball machines and the legal activity of operating music machines, amusement machines and vending machines, Respondent was therefore correct in disallowing the expenses of the entire business.

There were not complete records of amounts paid to winning players on the multiple-odd bingo pinball machines and respondent estimated these unrecorded amounts as equal to SO percent of the total amount deposited in such machines.

At the time of making the audit in 1958, respondent's auditor interviewed owners of four locations in which multiple-odd bingo machines acquired from appellant were operated during the years in question, Two of these location owners estimated that on the average the cash payouts equalled 60 percent of the coins deposited in the machines* One location owner estimated the cash payouts at 33-1/3 percent and another location owner stated that the cash payouts were "moderate." Each of the last two locations was in operation for only a short time,

We believe that the lower estimates of two of the location owners should not be wholly disregarded even though the length of time they operated was short. We find that the cash payouts on multiple-odd bingo pinball machines equalled 50 percent of the coins deposited in the machines.

Appellant has raised a question as to whether the notices of proposed assessment were timely, The notices of proposed assessment were issued by respondent on March 19, 1959, The returns for the years 1952, 1953, 1954, 1955, 1956 and 1957 were due on April 15, 1953, 1954, 1955, 1956, 1957 and 1958, respectively. (Rev, and Tax, Code, Par, 18432,) The notices of proposed assessment for 1954, 1955 1956 and 1957 were issued less than four years after the due date of the returns. The notices of proposed assessment for 1952 and 1953 were issued

more than four years and less than six years after the due date of the returns.

Section 18586 provides a general four-year period for respondent to issue a notice of proposed assessment. Section 18586.1 extends the period to six years if the taxpayer omits from gross income an amount in excess of 25 percent of the gross income stated in the return. Under either section, the time starts to run upon the filing of a return, except that if the return is filed prior to the final date for filing, the time starts to run on such final date. (Rev. and Tax. Code, Par. 18588,)

The notices of proposed assessment were timely for the years 1954, 1955, 1956 and 1957 under the general four-year limitation, For the years 1952 and 1953 appellant's unreported gross income computed in accordance with the earlier part of this opinion was less than 25 percent of the gross income reported in his returns and the assessments for these years were therefore barred.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section i8595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Allen C. and Mildred Anderson to proposed assessments of additional personal income tax in the amounts of $2,273.85, $2,333.46, $2,883.02, $2,962.12, $2,911.06 and $2,659.93 for the years 1952, 1953, 1954, 1955, 1956 and 1957, respectively, be modified for the years 1954, 1955, 1956 and 1957 in that the gross income is to be recomputed in accordance with the opinion of the board and that the action for the years 1952 and 1953 be reversed. In all other respects, the action of the Franchise Tax Board is sustained.

Done at Pasadena, California, this 27th day of November, 1962, by the State Board of Equalization,

George R. Reilly, Chairman
Richard Nevins, Member
Paul R. Leake, Member
John W. Lynch, Member
_____, Member

ATTEST: Dixwell L. Pierce, Secretary